MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, **2016/2017 SESSION**

BAC2664 – AUDITING

(All Section / Groups)

3 MARCH 2017
9:00 AM – 12:00 NOON
(3 Hours)

INSTRUCTION TO STUDENT

1. This question paper consists of 8 pages with 5 questions only.
2. Answer **ALL** questions in the answer booklet provided.

QUESTION 1

PART A

i- "It is well accepted in auditing that throughout the conduct of the ordinary audit, it is essential to obtain large amounts of information from management and to rely heavily on management's judgments. After all, the financial statements are management's representations, and the primary responsibility for their fair presentation rests with management, not the auditor. For example, it is extremely difficult, if not impossible, for the auditor to evaluate the obsolescence of inventory as well as management can in a highly complex business. Similarly, the collectability of accounts receivable and the continued usefulness of machinery and equipment are heavily dependent on management's willingness to provide truthful responses to questions."

Required:

Reconcile the auditor's responsibility for discovering material misrepresentations by management with these comments.

(3 marks)

ii- You are the audit senior of Anisah & Co. The partner in your firm has just been approached by the managing director of Cemerlang Maju Bhd, a manufacturer of fitness equipment, to perform its audit for the next accounting year ending 30 June 2016. The partner asked you to do some research about Cemerlang Maju Bhd to help her decide whether to accept the audit engagement. In your review of the financial press, you found the following articles concerning Cemerlang Maju Bhd.

1- An article on 5th August 2015 questioning Cemerlang's policy on capitalizing research and development for the first time in 2015.

2- An article on 27th September 2015 announcing the resignation of the two directors from the board of five directors.

Required:

Discuss whether the above two issues affect the audit partner's decision on accepting the engagement.

(5 marks)

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PART B

With reference to ISA 700: *Auditor's Report on Financial Statements,* indicate the type of audit report that you would issue for each of the following independent situations and explain your reasoning. Assume that each item is at least material.

a- The management of Bistari Maju Sdn Bhd has decided to exclude the statement of cash flows from its financial statements because it believes that its bankers do not find the statement to be very useful.

b- You are auditing Syarikat Mawar Gas Sdn Bhd, a manufacturer of cooking gas for the year ended 30 September. On 1 September, one of its manufacturing plants caught fire and killed ten people including the public. The company's legal counsel indicates that the company is liable and that the amount of the liability can be reasonably estimated, but the company refuses to disclose this information in the financial statements.

c- During your audit of Cendana Putih Sdn Bhd, the financial controller, Tiara Mia, refuses to allow you to confirm accounts receivable because she is concerned about complaints from her customers. You are unable to satisfy yourself about the accounts receivable by other audit procedures and you are concerned about Tiara's true motives.

d- On 31 January, Cantik Toy Manufacturing Sdn Bhd hired your firm to audit the company's financial statements for the prior year. You were unable to observe the entity's inventory on 31 December. However, you were able to satisfy yourself about the inventory balance using other audit procedures.

e- Gemersik Sdn Bhd leases its manufacturing facility from a partnership controlled by the chief executive officer and major shareholder of Gemersik. Your review of the lease indicates that the rental terms are in excess of rental terms for similar buildings in the area. The company refuses to disclose this related-party transaction in the notes.

f- Jentayu Manufacturing Sdn Bhd has used the double-declining balance method to depreciate its machinery. During the current year, management switched to the straight-line method because it felt that it better represented the utilization of the assets. You concur with its decision. All information is adequately disclosed in the financial statements.

(12 marks)

(Total: 20 marks)

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QUESTION 2

PART A

You are the engagement partner for the audit of Aneka Advert Sdn Bhd. You have performed the audit procedures on the company and gathered the following information. Aneka Advert is an advertising company and owned by Azilah Najmi. Maniam is an officer of Aneka Advert who has worked for the company for almost twelve years. He is among the staff trusted by Azilah. Whenever there are potential customers that require the company's service, Maniam will deal with them and decide on the fees and the payment schedules. Azilah leaves most of the business dealings to Maniam and he will be given a 5% bonus on the total amount charged to the customer.

When a customer decides to take the service of the company, an agreement is prepared by the clerk, Salimah. All the terms and agreement are decided by Maniam without referring to the standard policy of the company. The customer may pay a deposit of 20% of the total amount or he may defer the deposit payment to a later date. However, this needs Maniam's approval.

Celina Lim, who is in charge of the accounting matters, will record the deposits and other payments by the customers. It is the company's policy to receive all payments by cheques. However, due to some unavoidable circumstances the company will accept cash payments. She is also in charge of filming some advertisements that requires to be out of the office most of the days in a week. Whenever she is not in the office, Maniam will receive the payments.

Azilah comes to the office once in two weeks to check whether the work schedules are on time. She will also check on the payment received and if there are differences between the amount recorded and the statement that she requested from the bank, she will ask Celina to make the necessary adjustments to the books of accounts. Sometimes, she herself calls the customer to ask about the progress of the payment. Azilah employs a part-time clerk to prepare the bank reconciliation statement at the end of every month.

Required:

a- Identify four weaknesses in the existing internal control system and the possible consequences. For each of the weaknesses, suggest recommendations that can improve the system.

Present your answer in the following format:

Weaknesses of the internal control system	Possible consequences	Recommended procedures

(12 marks)

Continued...

b- Identify two strengths of Aneka Advert's internal control system.

(2 marks)

c- Explain the importance of performing tests on the client's internal control system.

(1 marks)

PART B

Reserves may include share premium, retained profits and other types of reserve such s capital, revaluation and foreign exchange reserves. These accounts are affected by transactions such as revaluation of properties, foreign exchange adjustments, dividend payments and acquisitions of treasury shares. Retained profits is the portion of reserves that is distributable as dividends.

Required:

a- State four audit objectives on auditing reserves and retained profits.

(2 marks)

b- Explain four audit procedures on auditing reserves and retained profits.

(3 marks)

(Total: 20 marks)

QUESTION 3

PART A

As the audit senior at Azwa & Co, Halim recently had a discussion with Mr Raja, the accountant of Azwa & Co's audit client, Syarikat Makmur Sdn Bhd, regarding its sales and collection cycle. Mr Raja highlighted that as a manufacturer and supplier of chicken and beef in Lembah Klang, the company had a significant amount of trade accounts receivable. The company's sales are principally to the hotels and supermarkets in Lembah Klang. Syarikat Makmur Sdn Bhd has about 230 trade accounts receivables. During the year, Syarikat Makmur began to encounter cash-flow difficulties, and a cursory review by management revealed receivable collection problems.

Halim studied the billing and collection process and noted the following:

* The accounting department employs one bookkeeper, who receives and opens all incoming mail. This bookkeeper is also responsible for depositing receipts, filing remittance advices on a daily basis, recording receipts in the cash receipts journal, and posting receipts in the individual customer accounts and the general ledger

Continued...

accounts. There are no cash sales. The bookkeeper prepares and controls the mailing of monthly statements to customers.

* The concentration of functions and the receivable collection problems caused Halim to suspect that a systematic defalcation of customers' payments through a delayed posting of remittances (lapping of accounts receivable) is present. Halim was surprised to find that no customers complained about receiving erroneous monthly statements.

Required:

a- Identify five procedures Halim should perform to determine whether lapping exists. Do not discuss deficiencies in the internal control systems.

(10 marks)

b- Provide four substantive tests of transaction for accounts receivable.

(5 marks)

PART B

The usefulness of analytical procedures as an audit evidence depends significantly on the auditor developing an expectation of what a recorded account balance or ratio should be, regardless of the type of analytical procedures used.

Required:

With reference to ISA 520 *Analytical Procedures*:

a- What are the purposes of preliminary analytical procedures?

(2 marks)

b- What types of comparisons are useful when performing preliminary analytical procedures?

(3 marks)

(Total: 20 marks)

Continued...

QUESTION 4

PART A

Mahbub Textiles Sdn Bhd is a medium size manufactures of textiles in Nilai, Negeri Sembilan. Melissa & Co is the company's auditor of Mahbub Textiles. Muzaffar, the senior auditor of Melissa & Co is considering the audit work to be performed in the accounts payable area for the current year's engagement. The prior year's working papers show that confirmation requests were mailed to 50 of Mahbub's 500 suppliers. The selected suppliers were based on Muzaffar's sample, which was designed to select accounts with large ringgit balances. A substantial number of hours were spent by Mahbub Textiles Sdn Bhd and Muzaffar resolving relatively minor differences between the confirmation replies and Mahbub Textiles's accounting records. Alternative audit procedures were used for those suppliers who did not respond to the confirmation requests.

Required:

a- Identify three important accounts payable balance-related audit objectives that Muzaffar must consider in determining the audit procedures to be followed.

(3 marks)

b- Identify situations in which Muzaffar should use accounts payable confirmations and discuss whether Muzaffar is required to use the accounts payable confirmations.

(3 marks)

c- Discuss why the use of large balances as the basis for selecting accounts payable for confirmation might not be the most effective approach and indicate what more effective procedures could be followed when selecting accounts payable for confirmation.

(4 marks)

PART B

Evidence comes in various types and has different degrees of reliability. ISA 500 *Audit Evidence* stated that reliability of evidence refer to the degree to which evidence can be believable or worthy of trust. Following are some statements that compare the various types of evidence.

1. An auditor's recalculation of depreciation versus examination of raw material requisitions.

2. A bank confirmation versus observation of the segregation of duties between cash receipts and recording payment in the accounts receivable subsidiary ledger.

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3. A bank statement included in the client's records versus shipping documents.

4. Physical inspection of common stock certificates held for investments versus physical examination of inventory components for personal computer.

Required:

a- For each situation above, indicate which evidence is more reliable. Provide a rationale for your choice.

(6 marks)

b- Identify two determinants of persuasiveness of evidence and explain how these determinants are related to audit procedures, sample size, items to select and timing?

(4 marks)

(Total: 20 marks)

QUESTION 5

PART A

In audit, cash is important because of its susceptibility to theft and it can also be significantly misstated. The amount of cash flowing into and out of the cash account is often larger than that for any other account in the financial statements. Furthermore, the susceptibility of cash to embezzlement is greater than for other types of assets because most other assets must be converted to cash to make them useable. One of the importance audit procedures for cash is receipt of a cutoff bank statement.

Required:

a- Describe what is meant by a cutoff bank statement.

(2 marks)

b- State the purpose of cutoff bank statement.

(2 marks)

c- When the auditor fails to obtain a cutoff bank statement, it is common to verify the entire statement for the month subsequent to the reporting date. How is this done and what is its purpose?

(4 marks)

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PART B

Inventory represents one of the most complex parts of the audit because the assignment of values to inventory quantities is difficult. There are also issues such as obsolescence and lowering of cost or value (net realizable value) that affect the valuation of inventory. The complexity of auditing inventory may also be affected by the degree of processing required to manufacture products. The inventory management process is affected by the control activities.

Required:

a- State three inherent risk factors that affect the inventory management process.
(3 marks)

b- State three major steps in assessing control risk for inventory.
(3 marks)

c- What control activities can an entity use to prevent unauthorised inventory production? (Give three control activities)
(3 marks)

d- State three substantive analytical procedures that can test the fairness of inventory and related accounts.
(3 marks)

(Total: 20 marks)

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